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PR10:41

For Immediate Release:
12/21/2010

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Controller's Review Finds Problems In Bell Audits

SACRAMENTO – State Controller John Chiang today published the results of a quality-control review of the City of Bell and the Bell Community Redevelopment Agency's audits, which found that the City's audit firm, Mayer Hoffman McCann (MHM) failed to follow the majority of applicable generally accepted fieldwork audit standards.

"MHM appears to have been a rubberstamp rather than a responsible auditor committed to providing the public with the transparency and accountability that could have prevented the mismanagement of the City's finances by Bell officials," said Chiang. "Had MHM fully complied with the 17 applicable fieldwork standards, it would have led them to identify some – if not all – of the problems my office has uncovered since August."

Cities – like counties and other local governments – must produce annual financial statements and use outside auditors to review those statements. These reports are used to determine the city's financial position, its ability to meet its obligations, and the performance of the city's management and governing board.

The purpose of any quality-control review is to ensure the city's contracted auditors followed generally accepted government audit standards, performed adequate testing and fieldwork, and were able to support their conclusions. This review of MHM's work found that the firm failed to fully comply with 13 of the 17 applicable fieldwork auditing standards. In particular, the firm's auditors complied in varying degrees with fieldwork standards regarding audit documentation and evidence, risk of fraud, and litigation, and their conclusions were not supported by their working papers.

MHM has worked as Bell's independent auditor since 2006, when it bought the City's previous audit firm, Conrad and Associates LLP. Conrad and Associates had performed audits for the City since 1994.

This review focused on the working papers behind MHM's latest audit of the City and redevelopment agency's 2008-09 financial statements. A copy of the review has been submitted to the California State Board of Accountancy.

At the firm's request, nearly all communications during the course of the review went through MHM's attorneys.

The Controller's review found that the firm did not adequately look for documentation and evidence to support the city's records, did not document the reason for deficit balances, management's plans for dealing with the financial conditions, or the adverse effect of deficit balances.

Instead the firm relied primarily on comparisons to prior year financial statements, requesting information on variances in excess of \$200,000 and 15 percent from the prior year. For example, a \$300,000 loan to a local business was not flagged for additional review because the same loan with the same value appeared in prior year statements. Instead, auditors should have reviewed the age and collectability of a loan that showed no repayment. An audit released by the State Controller earlier this year found the now-defaulted loan was made without the City Council's knowledge.

The firm's review of Bell's payroll was also limited to comparisons against prior years, and only looked at the City's General Fund, although salaries were charged to other funds. Had the firm reviewed the records for key employees, it should have noted that the Chief Administrative Officer had salary agreements with five other City funds. It should also have noted that the CAO's basic salary would increase if the General Fund maintained a positive balance, providing an incentive and risk for misappropriation of public dollars.

Additions to the City's assets, including a \$4.8 million land purchase from a former mayor, were not adequately reviewed. The firm's audit only looked at journal entries surrounding the purchase, but should have analyzed the valuation and existence of the building, which the City undervalued in its asset report by \$200,000. MHM should also have found that the appraisal supporting the land's value was more than a year old, and noted the potential conflict in such a large purchase from a former City official.

The firm did not document its consideration or evaluation of the City's ability to meet its obligations. The City had planned on leasing a parcel of land to a railroad and using those revenues to make payments on \$35 million of lease-revenue bonds. However, a 2008 ruling from the Los Angeles County Superior court blocked the lease because the City had not obtained an environmental review. The firm's working papers did not show any analysis or record of this issue and its financial effects, nor did they note the reason why the City had recently extended the maturity date of its bonds.

The review also found problems in the firm's audit of federal program compliance. The firm's auditors used outdated compliance guidelines and failed to adequately evaluate the City's controls over major federal programs or test all applicable requirements for those federal programs.

In a separate review of the City's Redevelopment Agency, the firm did not disclose that the Bell Community Redevelopment Agency had been sanctioned by the State for failure to make mandatory payments to local education agencies. There was no evidence in the firm's working papers that the auditor identified or considered the impact of this sanction. Sanctioned redevelopment agencies face several prohibitions – one is that their monthly administrative expenses may not exceed 75 percent of the average monthly amount spent for those purposes in the prior year. The Controller's review found that the City's Redevelopment Agency violated the sanction by increasing its yearly administrative expenses by 31 percent.

The firm also failed to determine whether expenditures made from the agency's Low and Moderate Income Housing Fund were related to the production, improvement or preservation of low and moderate income housing. An audit that fully followed the Redevelopment Agency audit guidelines should have questioned the validity of these expenses.

The [full report](http://www.sco.ca.gov) is available on the State Controller's website at www.sco.ca.gov.

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